



REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

August 14, 2007

The Honorable Tom Anzelc
Minnesota State Representative
KEDA Commission Member
44205 Burrows Lake Lane
Balsam Township, MN 55709

The Honorable Tom Saxhaug
Minnesota State Senator
KEDA Commission Member
75 Rev. Dr. Martin Luther King Jr. Blvd
Capitol Building Room 124
St. Paul, MN 55155

The Honorable Mike Hanson
Koochiching County Commissioner
KEDA Commission Chair
1740 County Road 86
Birchdale, MN 56629

Mr. Allen Rasmussen
KEDA Commission Vice Chair
116 Park Avenue
International Falls, MN 56649

The Honorable Chopper McBride
International Falls City Council
KEDA Commission Treasurer
1208 14th Avenue
International Falls, MN 56649

The Honorable Wade Pavleck
Koochiching County Commissioner
KEDA Commission Member
P.O. Box 1253
International Falls, MN 56649

The Honorable Shawn Mason
Mayor of International Falls
KEDA Commission Member
1019 2nd Street
International Falls, MN 56649

Ms. Karin Elhard
KEDA Commission Member
P.O. Box 63
Northome, MN 56661

The Honorable Chuck Lepper
Koochiching County Commissioner
KEDA Alternate
1113 13th Avenue
International Falls, MN 56649

The Honorable Gail Rognerud
International Falls City Council
KEDA Alternate
1121 9th Avenue
International Falls, MN 56649

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The Honorable Kallie Briggs
Koochiching County Commissioner
KEDA Alternate
301 2nd Street
International Falls, MN 56649

The Honorable Paul Eklund
International Falls City Council
KEDA Alternate
605 East 15th Street
International Falls, MN 56649

The Honorable Kevin Adee
Koochiching County Commissioner
KEDA Alternate
3176 County Road 24
International Falls, MN 56649

Mr. Rob Boyd
KEDA Alternate
Bremer Bank
345 4th Avenue
International Falls, MN 56649

Ms. Penny Strongman
KEDA Alternate
1207 14th Avenue
International Falls, MN 56649

Mr. Paul Nevanen
KEDA Director
P.O. Box 138
International Falls, MN 56649

Dear Koochiching County Economic Development Commission:

The Office of the State Auditor received notice that one of the banks used by the Koochiching Economic Development Authority (KEDA) had discovered unusual activity in one of KEDA's accounts. In response to that notification, we conducted an examination of certain KEDA financial records for the time period January 2, 2002 through April 16, 2007. As a result of our examination, we found:

- \$328,609.86 in questionable unauthorized KEDA checks;¹
- \$6,450.00 in additional unauthorized KEDA checks made payable to "cash" and endorsed by KEDA's Administrative Assistant;
- \$6,682.54 in additional unauthorized KEDA checks for which KEDA was unable to provide us with copies of the checks;² and
- Unauthorized transfers among financial accounts under KEDA's control.

During our review, we also identified a number of weaknesses in KEDA's internal controls and management practices.

¹ This letter reports on our analysis of documents that we obtained from KEDA. Our complete analysis, including documents that we received from law enforcement, has been provided to the Koochiching County Attorney. The report provided to the County Attorney and law enforcement may contain data that are not public at this time. *See* Minn. Stat. §§ 6.715, subd. 2, and 13.82, subd. 7. However, it is our understanding that KEDA is able to obtain a copy of that report from the County Attorney. *See* Minn. Stat. § 13.82, subd. 13. Based solely upon the documents we obtained from KEDA, we determined that \$191,508.02 of the \$328,609.86 amount was comprised of checks written to KEDA's Administrative Assistant.

² We identified additional unauthorized checks that appear to have been written to legitimate KEDA vendors.

A complete report of our findings has been provided to the Koochiching County Attorney's Office and the International Falls Police Department.³ Criminal charges related to issues discussed in this letter were filed.⁴ It is our understanding that a guilty plea was obtained based, in part, upon information that we provided to law enforcement.

The purpose of this letter is to provide KEDA with a brief summary of our findings, to make recommendations to help address the weaknesses identified, and to assist KEDA in protecting its assets in the future.

Background

The Koochiching County Economic Development Commission was established by the Legislature in 2000.⁵ The Commission is KEDA's governing body.⁶ It is comprised of two Koochiching County ("County") Commissioners, two members of the International Falls ("City") City Council, two County residents, and one state legislator representing the County.⁷ KEDA's duties include establishing the County's economic development priorities and approving the County's economic development projects.⁸

KEDA receives funding primarily from the City, the County, and the Iron Range Resources and Rehabilitation Board (IRRRB).⁹ KEDA also has various sources of income, including income received from the International Falls & Koochiching County Cold Weather Testing ("CWT") facility. KEDA also serves as the "fiscal agent" for various projects, including, according to KEDA meeting minutes, the Local Purchasing Market Plan, the Business Marketing Committee, and the Koochco Loan Program ("Koochco").¹⁰

³ We had previously provided the County Attorney and law enforcement with a preliminary analysis of documents that we had received from law enforcement.

⁴ See Koochiching County District Court Case No. 36-CR-07-112.

⁵ See Laws of Minnesota 2000, Chapter 484, art. 1, § 2. KEDA's website describes KEDA as a "non-profit economic development authority" for Koochiching County and as a "joint powers development authority between the City of International Falls and Koochiching County." See <http://www.businessupnorth.com/mission.shtml> and <http://www.businessupnorth.com/about.shtml> accessed July 16, 2007.

⁶ See Economic Development Authority of Koochiching County By-Laws, Section 1.1 (October 2004).

⁷ See Laws of Minnesota 2000, Chapter 484, art. 1, § 2, subd. 1.

⁸ *Id.* at subd. 2.

⁹ For example, in 2005, the City appropriated \$50,000 to KEDA. See KEDA Funding received from KEDA. The County appropriated \$50,000 from its Koochiching Development Authority to KEDA during 2005. See Koochiching County, Minnesota, Financial Statements and Supplementary Information, Year Ended December 31, 2005, page 38, note 10. The IRRRB appropriated more than \$90,000 to KEDA in 2005. See KEDA Funding received from KEDA.

¹⁰ See KEDA Meeting Minutes for August 27, 2003, item 05 (Local Purchasing Market Plan); KEDA Meeting Minutes for August 18, 2004, item 05 and KEDA Meeting Minutes for September 15, 2004, item 04 (Business Marketing Committee). KEDA's attorney informed us that Koochco is a non-profit entity. It provides loans to business entities. See KEDA's website at <http://www.businessupnorth.com/localbenes.shtml> accessed July 16, 2007.

KEDA's By-Laws require annual elections for the chair, vice chair and treasurer positions.¹¹ Under its By-Laws, KEDA's treasurer "is responsible for [KEDA] money and is responsible for the acts of the financial staff."¹² During the time period of our review, there have been several different KEDA treasurers. KEDA employed a Director and an Administrative Assistant.¹³ KEDA's Director informed us that the Administrative Assistant had physical control of KEDA's financial records and checkbooks.

Generally, KEDA meets monthly.¹⁴ At its meetings, KEDA considered a list of unpaid bills for approval.¹⁵ Checks approved for payment were to be signed by any KEDA executive officer and the KEDA director.¹⁶ If the KEDA director was unavailable, another executive officer was authorized to sign the checks.¹⁷ Koochiching County processed KEDA's payroll checks.¹⁸

At our request, KEDA provided us with copies of available KEDA bank statements, cancelled checks and check stubs for the time period January 2, 2002 through April 16, 2007.¹⁹ We also reviewed KEDA's Unpaid Bills Detail and meeting minutes for the same time period. Finally, we reviewed copies of certain KEDA checks that we received from law enforcement.²⁰

For the time period January 2, 2002 through April 16, 2007, we found \$328,609.86 in questionable unauthorized checks that were paid with KEDA funds. Based solely upon the documents we obtained from KEDA, we determined that \$191,508.02 of the \$328,609.86 was comprised of checks written to KEDA's Administrative Assistant. Our findings are summarized by year in the following chart:

¹¹ See Economic Development Authority of Koochiching County By-Laws, Section 2.1 (October 2004).

¹² See Economic Development Authority of Koochiching County By-Laws, Sections 2.5 (October 2004).

¹³ The current KEDA Director informed us that he began employment with KEDA in 2002. See also KEDA Meeting Minutes for February 27, 2002. KEDA's Director informed us that KEDA's Administrative Assistant worked for KEDA from June 2001 until April 2007.

¹⁴ KEDA's current By-Laws require "regular meetings"; the prior By-Laws required monthly meetings. See Economic Development Authority of Koochiching County By-Laws, Section 3.2 (October 2004).

¹⁵ See Economic Development Authority of Koochiching County By-Laws, Section 5.2 (October 2004).

¹⁶ See Economic Development Authority of Koochiching County By-Laws, Section 5.2 (October 2004); KEDA Meeting Minutes for November 17, 2004, item 06.

¹⁷ See Economic Development Authority of Koochiching County By-Laws, Section 5.2 (October 2004).

¹⁸ See Economic Development Authority of Koochiching County By-Laws, Section 5.2 (October 2004). We obtained the County's Employee History Report and samples of payroll checks for KEDA's Administrative Assistant. The payroll checks were County checks, not KEDA checks. According to a June 2001 position description for the Administrative Assistant position, the salary range for the position was \$9.00 to \$13.00 per hour, including benefits.

¹⁹ KEDA provided us with bank statements from two of its accounts through March 2007: KEDA's general account at Wells Fargo Bank and KEDA's Cold Water Testing account at Border State Bank. The bank statements from Border State Bank were incomplete, and only some of the bank statements contained check images. KEDA provided us with copies of the Wells Fargo checks that it could locate at the KEDA offices for 2002 through 2004, as well as checks that we asked KEDA to obtain from Wells Fargo Bank. KEDA provided us with copies of check stubs from the Wells Fargo Bank account for January 2006 through April 2007, but we were informed that the check stubs were missing for most, if not all, of the checks we identified as unauthorized.

²⁰ As previously noted in this letter, our complete analysis, including documents that we received from law enforcement, has been provided to the Koochiching County Attorney.

Year	Amount
2002	\$ 15,363.89
2003	\$ 52,363.15
2004	\$ 86,654.30
2005	\$ 70,172.49
2006	\$ 78,130.57
2007	\$ 25,925.46
Total	\$ 328,609.86

Our review also disclosed that an additional \$6,450.00 in unauthorized KEDA checks were written to “cash” and endorsed by KEDA’s Administrative Assistant. These checks were paid with KEDA funds, and are summarized by year in the following chart:

Year	Amount
2002	\$5,450
2003	\$1,000
Total	\$6,450

We also found additional unauthorized checks that were paid with KEDA funds, where we were unable to identify the payee on the checks because KEDA was unable to provide us with copies of the checks. These additional unauthorized checks are summarized by year in the following chart:

Year	Amount
2002	\$3,748.63
2003	\$2,933.91
Total	\$6,682.54

During our review, we found transfers among financial accounts under KEDA’s control for which we found no authorization in the meeting minutes. For example, we observed transfers involving KEDA’s general account, KEDA’s cold weather testing account, and the Koochco account. We also reviewed a report from Koochco’s accountant indicating that he had discovered unauthorized transfers from Koochco’s account into KEDA’s accounts.²¹

²¹ See July 2, 2007, Report to Koochco, Inc., from Randy Pozniak, CPA.

Recommendations

We make the following recommendations to help KEDA address some of the weaknesses identified during our review and to assist KEDA in protecting its assets in the future. We look forward to working with KEDA and its auditors to resolve issues raised by our review.

1) Obtain Annual Audits

The legislation creating KEDA does not require audits. It is our understanding that KEDA was planning to have its first audit performed in 2007.²² We recommend that KEDA have an annual audit performed. Based upon the transfer of funds that we found during our review, we also recommend that audits be performed for all accounts/entities over which KEDA exercised control.

Our recommendation regarding annual audits is consistent with legislation that the Office of the State Auditor recommended for the past two legislative sessions.²³ Specifically, the legislation would have required annual audits for “special districts” with revenues above a specified amount.²⁴ The legislation also would have required special districts to file their audits with the State Auditor. The legislation was not enacted.

2) Review Bank Statements

To guard against unauthorized disbursements and fund transfers, someone other than the person writing the checks should be reconciling the monthly bank statements. More specifically, someone other than the Administrative Assistant should receive the unopened bank statements and perform the bank reconciliation. Because KEDA has a small staff, we recommend that the KEDA Treasurer, KEDA Director, or a Commission member, perform the bank reconciliation and compare the monthly bank statements with the claims authorized for payment at the prior KEDA meeting. We recommend that the original bank statements received from the bank be reviewed, rather than a bank reconciliation document prepared by the Administrative Assistant.

3) Obtain Optical Images of Cancelled Checks

Our review was delayed because KEDA did not obtain optical images of all cancelled checks from one of its financial institutions. We believe that a brief review each month of the images contained in the bank statements would have revealed that unauthorized checks were written. We recommend that KEDA obtain optical images from its financial institutions as part of the monthly bank statements if possible.

²² See KEDA Meeting Minutes for January 12, 2007, item 05.

²³ See S.F. No. 2612 and H.F. No. 2730 (2005-2006); S.F. No. 1436 (2007-2008).

²⁴ KEDA had sufficient revenues to need an annual audit under the proposed legislation. For “special districts” with smaller revenues, audits would have been required at least once every five years.

4) Review Petty Cash Procedures

We found numerous checks written for petty cash, some of which were not authorized by KEDA. We recommend that KEDA review its petty cash procedures, and consider reimbursing employees for expenses or paying vendors directly to decrease KEDA's need for a petty cash fund. We recommend that KEDA work with its private auditors to review KEDA's petty cash procedures, and to develop better controls in this area.

5) Unauthorized Transfers Among Accounts

We found unauthorized transfers among the financial accounts under KEDA's control. We recommend that KEDA work with its auditors to develop internal controls for transfers among accounts under KEDA's control.

6) Unauthorized Checks to KEDA Vendors

In addition to the unauthorized checks discussed in this letter, we found other unauthorized checks that were written to legitimate KEDA vendors. We will work with KEDA and its auditors so they can determine whether these payments were for legitimate KEDA claims. We recommend that KEDA's minutes record all KEDA claims approved for payment.²⁵

7) Document Retention

Our review disclosed that KEDA did not maintain a full and complete set of bank statements and other financial documents. All public authorities or political entities within the state must make and preserve all records necessary for "a full and accurate knowledge of their official activities."²⁶ The entity and its chief administrative officer are responsible for the preservation of the entity's records.²⁷ We recommend that KEDA's financial records be maintained in compliance with Minnesota law.²⁸

²⁵ Beginning with KEDA's November 30, 2005, meeting minutes, the minutes reflect the total amount approved for payment from the KEDA and the CWT accounts. This is a better practice than KEDA's prior minutes which noted the approval of claims, but did not provide a dollar total for the claims approved.

²⁶ See Minn. Stat. § 15.17, subd. 1.

²⁷ See Minn. Stat. § 15.17, subd. 2.

²⁸ See Minn. Stat. § 138.17, subd. 7.

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Conclusion

KEDA is responsible for establishing and maintaining internal controls. We look forward to working with KEDA and its auditors to improve the weaknesses identified during our review.

Sincerely,

Rebecca Otto

State Auditor

cc: Joseph Boyle, KEDA Attorney
Phil Miller, Koochiching County Attorney
Sgt. Mike Musich, International Falls Police Department